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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Accounting for Judgments and Other Costs Associated with Litigation	)	CC Docket No. 93-240
	)	

REPLY COMMENTS OF
MCI TELECOMMUNICATIONS CORPORATION

MCI TELECOMMUNICATIONS CORPORATION

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DATED: November 5, 1993

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SUMMARY

MCI Telecommunications Corporation replies to the comments in response to the Federal Communications Commission's Notice of Proposed Rulemaking (Notice), which proposes accounting rules for treatment of judgments and litigation costs incurred in cases involving violations of federal antitrust laws and other statutes. The local exchange carriers (LECs) generally oppose the Commission's Notice in a transparent, self-serving attempt to advance the interests of their stockholders to the detriment of ratepayers. Their comments evidence a misunderstanding of the court's directive to the Commission and are conflicting and confused about the incentives created by the Commission's proposed rules. In fact, a comprehensive analysis of carrier incentives indicates that the public interest is best served by adopting rules which presumptively exclude settlements as well as adverse judgments and the associated legal costs for any case involving the violation of a federal statute. Thus, MCI urges the Commission to establish rules consistent with these policy objectives.

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MCI Telecommunications Corporation (MCI) hereby replies to the comments filed on October 15, 1993, in response to the Federal Communications Commission's (FCC's or Commission's) Notice of Proposed Rulemaking (Notice),[1] which proposes accounting rules for treatment of judgments and litigation costs incurred in cases involving violations of federal antitrust laws and other statutes. The local exchange carriers (LECs) generally oppose the Commission's Notice in a transparent, self-serving attempt to advance the interests of their stockholders to the detriment of ratepayers. Their comments evidence a misunderstanding of the court's directive to the Commission and are conflicting and confused about the incentives created by the Commission's proposed rules. Thus, MCI urges the Commission to discount the LECs' complaints and implement rules as recommended in these reply comments.

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[1] FCC 93-424, 8 FCC Rcd ____, released September 9, 1993.

I. The FCC Has Correctly Interpreted Judicial Precedent

Contrary to the assertions of several carriers, the Commission is appropriately considering the Litigation Costs Remand[2/] and the Litton[3/] case in responding to the Court's remand.[4/] The court in each case recognized that the formulation of procedures is basically to be left within the discretion of the agencies to which Congress has confided the responsibility for substantive judgments.[5/] However, in neither case was the court convinced that the Commission had adequately explained the

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[2/] Mountain States Tel. and Tel. Co. v. FCC, 939 F.2d 1035 (D.C. Cir. 1991).

[3/] Mountain States Tel. and Tel. Co. v. FCC, 939 F.2d 1021 (D.C. Cir. 1991).

[4/] The NYNEX Telephone Companies (NYNEX) (at 3), the United States Telephone Association (USTA) (at 4-5) and US West Communications, Inc. (US West) (at 2-4) argue that the Commission may not rely on the Litigation Costs Remand case, in which dicta is favorable to the Commission's proposal, and choose to ignore the case regarding the Litton antitrust expenses that is unfavorable to the proposal. BellSouth Telecommunications, Inc. (BellSouth) (at 5) claims that the Commission fails to recognize the controlling legal standard for the inclusion of operating expenses in ratemaking. Southwestern Bell Telephone Company (Southwestern Bell) (at 6-8) argues that the proposed rules conflict with established judicial and regulatory standards. Communications Satellite Corporation (Comsat) (at 6-8) contends that the Litigation Cost decision's affirmance of the ratepayer benefit principle is "irrelevant" since the proposed method of implementing this principle is "fundamentally flawed," and that the Litton Appeal found that the Commission had not adequately justified a radical departure from longstanding accounting and ratemaking policies.

[5/] Litton, 939 F.2d at 1034-1035. In the Litigation Costs Remand the court noted "We approach the FCC's ratemaking and accounting classification decisions deferentially, reversing only if the agency's action is arbitrary and capricious. Litigation Costs Remand, 939 F.2d at 1042.

rationale underlying its rules.[6] In reviewing the earlier litigation cost rules[7] the D.C. Circuit concluded that such rules could be valid. However, the Court in Litigation Costs Remand remanded the issue because the Commission had not adequately justified the scope of the rules, i.e., the Commission had not adequately justified the application of the rules beyond the antitrust context, and there were gaps in the Commission's analysis of the various incentives facing the carriers.[8]

Thus, the Commission now has legal flexibility to fashion rules with respect to litigation costs with sufficient rationale. The Commission needs only to respond to the concerns specifically remanded in the Litigation Costs Remand. Litton is relevant background to illuminate some of the potential gaps in analysis about which the court was concerned, and the Commission has appropriately requested comment on its relevance to the proposed rules.

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[6] In Litton, the court stated

> We do not suggest that the Commission cannot provide an acceptable rationale for application of the challenged orders in the precise form in which they are, or that it is powerless to bind carriers to the strictures of those orders in some situations. We do say that before the Commission may do either in any instance, it first must come forth with what the law demands.

939 F.2d at 1035.

[7] Part 31 Uniform System of Accounts for Class A and Class B Telephone Carriers to Account for Judgments and Other Costs Associated with Antitrust Lawsuits, and Conforming Amendments to the Annual Report Form M, Report and Order, 2 FCC Rcd 3241 (1986), reconsidered, 4 FCC Rcd 4092 (1989).

[8] Litigation Cost Remand, 939 F.2d at 1042.

In Litton, the court found that precedent did not support a conclusion that actions found to be illegal were necessarily to be excluded from the ratebase. However, the court recognized that the Communications Act imposes upon the Commission the duty of regulating the rates chargeable for interstate telecommunications service with a view to ensuring that they are just and reasonable. 939 F.2d at 1029, citing 47 U.S.C. §§ 201-201. Further, the court noted that regulatory authorities may disallow expenses actually incurred in the company's operation when the challenged expense is found to be exorbitant, unnecessary, wasteful, extravagant, or incurred in the abuse of discretion or in bad faith; or when the cost is nonrecurring in nature. 939 F.2d at 1029.

Therefore, the Commission had simply failed to adequately meet its obligation to explain its rationale for its accounting treatment of litigation costs in federal antitrust actions. In particular, the court was concerned about the inconsistency in treating federal antitrust violations differently from infringements regarding state antitrust and other federal statutes. 939 F.2d at 1034. Thus, as the rules proposed herein create the appropriate incentives and are in the public interest, there is no judicial precedent that prevents their adoption.

II. Public Policy Supports the Commission's Presumptive Exclusion Policy

The carriers are split on the whether the Commission's presumption policies are appropriate for judgments or litigation costs. Comsat (at 8) claims that the broad presumption of disallowance which underlies the Commission's proposed rules "has no valid basis in fact, law or sound public policy." Southwestern Bell (at 8-9) asserts that the Notice uses an unfair, arbitrary and capricious standard as a basis for its presumption, and that the rationale for imposing the presumption is based on false assumptions. However, NYNEX (at 7) supports, in principle, the Commission's proposal to require antitrust judgments to be recorded below the line. PacTel (at 4) argues that adverse antitrust judgments can be recorded in nonoperating accounts. Yet NYNEX (at 12) and Southwestern Bell (at 9-10) contend that litigation expenses should be presumed to be reasonably and prudently incurred, until challenged, as are other business expenses.

The carriers are obviously confused about their arguments and fail to consider the primary concern of the court, i.e., the effect of the regulatory rules on the incentives of the carriers. These commenters are basing their "reasonableness" argument on the wrong element of conduct; it is not the defense of the lawsuit that is presumed to be nonbeneficial to ratepayers but the initial conduct which led to violation of a federal law. These carriers are arguing that the Commission should blindly allow any and all litigation costs merely because management has made a business judgment that breaking the law is in the company's best interest.

It is especially ironic that NYNEX (at 12) is making this reasonableness argument since NYNEX is a company whose inclusion of expenses, including litigation expenses has so frequently been the subject of dispute. See Comments of Scott Rafferty, filed Oct. 29, 1993. In a recent New York regulatory case, the state's legal staff found that NYNEX's "business judgement" involved allocating to its New York Telephone subsidiary litigation costs that clearly did not benefit New York ratepayers -- or even relate to services in New York. See Proceeding To Investigate Performance-Based Incentive Regulatory Plans for N.Y. Tel. Co., New York Public Serv. Comm'n Case No. 92-C-0665, Direct Testimony of Charlie Donaldson, New York State Department of Law, pp. 41-65, dated Sept. 7, 1993.

In order to clarify the incentives, MCI has outlined, in the Attachments to these Reply Comments, the stockholder economic risks and advantages that a company would need to weigh in several situation in deciding whether to aggressively interpret, i.e. risk breaking the law. Presumptively, if the stockholder risks are greater than the stockholder advantage, the company will be economically incented to avoid the arguably illegal activity.

For example, the first case is one of Normal Business Incentives (Attachment I), i.e., incentives outside of the regulated environment. Here, the risk to the stockholders is equal to the chance of litigation, i.e., the probability that someone will prosecute a case against the company, multiplied by the chance of losing the case if someone prosecutes, multiplied by the probable cost of an adverse judgment. Management must also consider the costs of litigation, e.g., attorneys fees, damage to reputation, etc.

On the other hand, the economic advantage to taking an aggressive, possibly illegal position is the chance of litigation, i.e., the probability that someone will prosecute a case against the company, multiplied by the chance of winning the case, multiplied by the cost of complying with the strict letter of the law. Management must subtract from that the chance of litigation multiplied by litigation costs. It is also an advantage to the company to take an aggressive stance if there is no resulting litigation. Thus, the chance of no-one litigating against the company multiplied by the cost of compliance with the law must be added to the theoretical advantage.

Thus, theoretically, in a normal business context, a company will weigh the risks and advantages of the aggressive stance. If the risks are greater than the advantage, the company is incented to avoid the arguably illegal behavior.

In the Attachments, MCI has outlined the risks and advantages for carriers in several situations. Specifically, MCI reviewed the differences from Normal Business Risks for Rate of Return Carriers (Attachment II) and Price Cap Carriers (above and below the sharing threshold) (Attachment III). MCI has outlined the attendant risk/benefit analysis depending upon whether: (1) adverse judgments and litigation costs are included in the ratebase, (2) adverse judgments are excluded from the ratebase, but all litigation costs are included in the ratebase, and (3) adverse judgments and associated litigation costs are excluded from the ratebase.

Several conclusions may be drawn from this analysis. First, in the normal business context, managers weigh risks and advantages of aggressive interpretation in order to maximize the return to their shareholders.

Second, absent the Commission's presumptive exclusion rules in the price cap environment, management is incented to act in the same manner as management in the normal business context regardless of whether the carrier is below the sharing threshhold. Bell Atlantic Telephone Companies (Bell Atlantic) (at 1) argue that price cap regulation discourages imprudent and wasteful management decision by ensuring that they harm shareholders rather than ratepayers. The incentives for efficiency, it contends, are designed to eliminate the need for Commission scrutiny of individual management decisions and he resulting revenue requirements. Bell Atlantic (at 2) is correct that, in a price cap environment, harm to ratepayers from litigation costs occurs when those costs reduce the earnings available for sharing or hold a carrier's earnings below the point at which sharing otherwise would be required. Commission presumptions change a price cap carrier's incentives only if it is above the sharing level, where the impact of Commission rules is similar for price cap and rate of return carriers.

Third, absent Commission presumptive exclusion rules, rate of return carrier management (or, when above the sharing measure, price cap carrier management) has little (less) incentive to maximize economic benefit, as the ratepayer is footing the bill (part of the bill) regardless of the decision management makes. Nor does management have significant incentive to minimize litigation costs. Thus, for rate of return carriers, the Commission must create an incentive if wasteful litigation costs are to be avoided and the public interest in curtailing illegal activity is to be realized.

The Commission's general premise that a carrier should not be able to recover from ratepayers the penalties assessed against it and other litigation costs incurred in connection with its violations of the law is sound public policy. Congress devises legislation directing certain corporate conduct that it determines will be in the public interest. Therefore, compliance with those laws should be presumed to be in the interest of the public, while violations of those statutes logically can be considered to be against the public interest, and by extension against the interests of interstate ratepayers. Absent the presumption of excluding adverse judgments and costs of unsuccessful litigation, rate of return carriers have no incentive to follow public policy or avoid wasteful litigation. For consistency and to create the proper incentives for price cap carriers above the earnings threshold, the same rules should apply to both price cap and rate of return carriers.

Finally, the Commission has a further interest in requiring all carriers to go beyond normal business incentives with respect to violations of laws, particularly laws designed to protect the ratepayer. The Commission is charged with protecting the interests of interstate ratepayers and, in the usual conduct of its authority, it balances the interests of ratepayers against the interests of shareholders of the regulated carriers. The Commission balances these interests when it conducts a review of the carrier's rates and when it makes a determination of what costs or investments should be included in or excluded from the ratebase. In remanding the previous litigation costs decisions, the D.C. Circuit noted that "it is a legitimate aim of rate regulation to protect ratepayers from having to pay charges unnecessarily incurred, including those incurred as a result of the carrier's illegal activity...". 939 F.2d at 1043.

In determining whether costs should be excluded, regulators routinely analyze the costs in terms of whether they are "used and useful" to the ratepayers. See e.g., Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989).[9/] To allow otherwise would be

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[9/] The costs of judgments, settlements and other litigation expenses should be seen as no less a part of that analysis than, for example, the costs of plant construction. The Commission's long-established rules appropriately recognize the inequity of requiring current ratepayers to bear the cost of construction which will not benefit them. See American Tel. and Tel. Co. -- Charges for Interstate Services, Docket No. 19129, 64 FCC 2d 1, 60 (1977), reconsidered 67 FCC 2d 1429 (1978), aff'd Illinois Bell Tel. v. FCC, 911 F.2d 776 (D.C. Cir. 1990).

contrary to the public interest. Aggressive carrier interpretation of laws designed to protect ratepayers is certainly not an activity "used and useful" to ratepayers, as it is likely to harm ratepayers even if it is in the carrier's economic best interest. Thus, adverse judgments, settlements and other litigation costs related to violations of federal statutes should be presumptively excluded from the ratebase. Especially in the context of antitrust and the Communications Act, the Commission must strike a balance in favor of protecting the ratepayer by increasing the carriers' economic incentive to avoid violating the law. Clearly, a rule requiring exclusion of litigation costs for lost causes and adverse judgments would accomplish this result. The D.C. Circuit's also agrees that "the FCC may disallow any expense incurred as a result of carrier conduct that cannot reasonably be expected to benefit ratepayers." 939 F.2d at 1043.

Bell Atlantic (at 4-5), BellSouth ((at 36), NYNEX (at 17-19), PacTel (at 16-17) and US West (at 11-12) argue that the proposed rules cannot be extended to other types of statutory violations. USTA (at 29-30) contends that the Commission should focus on judgments in federal antitrust litigation of sufficient magnitude to justify the significant accounting changes and the necessary reasonableness evaluation that would required.

MCI agrees with the Commission's interest in extending the policy to violations of other federal statutes in which the actions did not benefit ratepayers. The public interest in not allowing recovery of expenses which produce no benefit for the ratepayers is equally valid in connection with violations of nonantitrust federal statutes. The Commission would appear to be on the strongest ground when extending this disallowance policy to cases involving violations of the Communications Act, enforcement of which the Commission clearly has authority.[10] 47 U.S.C. § 208. It would be an egregious abuse of the ratemaking process for a carrier to be able to recover the expenses it incurs in a case brought by ratepayers to redress the carrier's violation of the Communications Act. Moreover, it is difficult to imagine a situation in which a carrier would be able to prove that violating the Communications Act produced a benefit for ratepayers.

Ameritech (at 3) asserts that if a carrier violates the law -- especially tax and environmental laws -- it most likely did so in such a way as to reasonably interpret the law to limit or decrease expenses to the company. Thus, it continues, the ratepayers benefit from lower expenses and therefore these litigation expenses should be treated as normal expenses. Ameritech is certainly lacking in imagination if it cannot fathom a scenario where ratepayers are harmed by the violation of federal laws. Many provisions of the Communications Act are specifically designed to protect ratepayers. Although it may be

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[10] MCI notes that the D.C. Circuit seemed troubled by possible extension of the policy beyond the context in which the Commission has some statutory authority for enforcing compliance with the law. 939 F.2d at 1042-46.

in the stockholders interest to violate these laws, it is certainly not in the interest of the ratepayer.

In conclusion, rules which would exclude adverse judgments and litigation costs for lost cases plainly benefit the public interest with respect to rate of return carriers by tipping the scales in favor of avoiding illegal activity and wasteful litigation costs. Such rules would also appropriately require price cap carriers to go beyond normal business incentives, biasing decisions in favor of avoiding illegal activity whenever these carriers are above the sharing level.

III. The Commission's Accounting Treatment in Presumptively Excluding Adverse Judgments from the Ratebase is Appropriate.

The Notice proposes to require that antitrust judgments be recorded in a nonoperating account, specifically account 7370, Special Charges. The Commission states that costs recorded in account 7370 are given special regulatory scrutiny, and are presumptively excluded from costs of service in setting rates.

NYNEX (at 7) supports, in principle, the Commission's proposal to require antitrust judgments to be recorded below the line and PacTel (at 4) argues that adverse antitrust judgments can be recorded in nonoperating accounts. Based on the incentives outlined above, MCI agrees.

As mentioned in the Notice (at 3, ¶ 10), the carrier would have the opportunity, in a rate case, to demonstrate that ratepayers derived a benefit from the behavior that gave rise to the lawsuit. Therefore, before being allowed to include adverse judgments in its ratebase, the carrier violating federal law bears the burden of demonstrating how its wrongdoing produced a benefit for ratepayers. As demonstrated above, to adopt any other policy would provide the carrier with no economic incentive to obey federal statutes.[11]

IV. The Commission Is Correct in Presumptively Excluding Settlements from the Ratebase.

The Notice proposes to require carriers to record antitrust settlements in account 7370 to be given special regulatory scrutiny and presumptively excluded from the ratebase. However, the Commission proposes to allow antitrust litigation expenses charged to account 1439 to be booked in operating accounts in the event of a prejudgment settlement.

The carriers are divided on the treatment of settlements. MCI agrees with Comsat (at 17) and BellSouth (at 28-30) that there should not be a distinction made between prejudgment and postjudgment settlement costs for purposes of accounting. However, US West (at 8-9) contends that prejudgment settlements should be recorded in above-the-line accounts in their entirety. NYNEX (at 8-9) argues that prejudgment settlements should be recorded above the line, while settlements following adverse antitrust judgments should be accounted for below the line.

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[11] Moreover, a carrier's management is more likely to settle a case of low merit if it knows that the company's ratepayers may ultimately bear the economic loss of costly litigation.

NYNEX claims (at 8) that the Commission can disallow prejudgment settlements in a ratemaking proceeding "if there is evidence of improper incentives being acted upon." MCI notes, however, that such an approach would be inconsistent with the court's concerns in the Litton case in which an allowance and subsequent disallowance was overturned. 939 F.2d at 1029-30.

PacTel (at 5-9) asserts that prejudgment settlements should be recorded above the line and that postjudgment settlements also should be recorded in operating accounts. Southwestern Bell (at 15) similarly claims that imposing a presumption of disallowance on settlements based on their alleged violation of federal statutes is arbitrary and capricious and will have an adverse effect on litigation. Southwestern Bell (at 15), PacTel (at 7-8) and USTA (at 23-24) claim that management has many reasons other than inclusion in the ratebase for not litigating a case through to judgment, implying that these exclusion rules have little impact on carriers' incentives to settle. On the other hand, Southwestern Bell argues (at 18-19) that the presumption of exclusion creates an incentive for a carrier to reject settlement to be able to recover a portion of costs, and to appeal cases involving multiple counts "even if escape from total liability does not seem probable." The carriers seem unable to make up their minds on whether the Commission's exclusion policy will have an impact on settlement. Their inconsistent analysis should be ignored.

MCI supports the placement of settlements into a nonoperating account and allowing the carrier to assume the burden of showing how the settlement was in the public interest. MCI believes that settlements, whether prejudgment or postjudgment, should be excluded from the ratebase, except when a particular carrier can demonstrate that it was in the interest of ratepayers to engage in the conduct that led to the lawsuit and that settlement is in the public interest. Otherwise a carrier who becomes aware that an adverse judgment is imminent may settle for any amount just to qualify the payment as a settlement for inclusion in the ratebase.

V. Other Litigation Expenses Should Be Accrued in a Deferral Account.

The Notice proposes requiring carriers to accrue other expenses related to antitrust litigation in a deferral account (account 1439) until the case is resolved. Upon entry of an adverse, nonappealable final judgment or postjudgment settlement, these expenses would be charged to account 7370. If the case were resolved in favor of the carrier, the expenses would be amortized above-the-line for a reasonable period. The Notice proposes similar treatment for antitrust expenses associated with prejudgment settlement, *i.e.*, they would be booked in account 1439 as operating expenses.

MCI agrees that this deferral accounting method is a rational approach for treatment of other antitrust litigation expenses and encourages the Commission to extend this accounting treatment to litigation expenses incurred in nonantitrust cases.

The Court appears to have found the previous rule offensive because it allowed expenses to be placed into a recoverable account and then later recaptured those expenses for exclusion.[12] Placing the amounts into a deferred account should avoid the retroactive ratemaking problem because carriers could not presume that these expenses would be recoverable.

Bell Atlantic (at 2-3) and PacTel (at 11-12) argue that litigation expenses should be recorded above the line as incurred pending the outcome of the litigation. Bell Atlantic (at 3-4), NYNEX (at 12-14) and Comsat (at 11-12) contend that the FCC can continue to evaluate under the "just and reasonable" standard any litigation costs (initially recorded above the line) and to exclude those costs from rates in particular cases.

This approach, however, would be inconsistent with the D.C. Circuit's ruling in the Litton case. As MCI stated in its comments, the primary regulatory error for which the Commission's decision was remanded in the Litton case was not the disallowance, *per se*, but the disallowance after having allowed the expenses to be claimed in an operating account. 939 F.2d at 1029-30. The proposal under examination here should avoid the problem which caused that court to overturn the Commission's disallowance in the Litton case because it places the amounts

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[12] The Litton court vacated the Commission's disallowance of judgment and litigation expenses based on the principle of retroactive ratemaking. 939 F.2d at 1029-30. The court appears to have been offended because the Commission had allowed AT&T to claim the costs of the Litton litigation "above the line" but later directed AT&T to move those costs "below the line" and disallowed recovery.

into a nonoperating account.

VI. Administrative Issues are Insufficient to Invalidate the Proposed Accounting Rules

Several carriers assert that the proposed rules will impose direct and indirect costs on the carriers and ratepayers that exceed any perceived benefit.[13] Others claim that they are unworkable and are not consistent with generally accepted accounting principles.[14] Some commenters assert that the proposed deferral accounting for litigation costs is administratively burdensome.[15] These arguments are unpersuasive.

Bell Atlantic notes that if costs are collected in a deferral account, they will not be reflected in its earnings for sharing purposes. It fears that a carrier might be charged with overearnings during the period in which those costs are deferred and would have to share those supposed overearnings with ratepayers even though the outcome of the litigation may be favorable to the carrier and the Commission may later allow the

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[13] BellSouth at 17. See, also, Southwestern Bell at 19 (proposal requiring carriers to track litigation expenses in a balance sheet deferral account is overly burdensome and will create adverse litigation incentives).

[14] See, Bell Atlantic at 3, BellSouth at 11-12, NYNEX at 15, PacTel at 14, Southwestern Bell at 20-21, USTA at 18-19, and US West at 9-11 (proposal to require deferral accounting for litigation costs is contrary to generally accepted accounting principles).

[15] Comments of BellSouth (at 31-34), Comsat (at 22) and Southwestern Bell (at 22-23).

expenses.

Inconsistency with GAAP is relevant only to the administrative simplicity of implementing the current rules. It is not a requirement of ratemaking.[16/] Clearly, the administrative costs of tracking litigation expenses pale in light of the public interest benefits of presumptive exclusion. In any event, carriers must track litigation expense as a normal part of separating costs between jurisdictions and regulated/nonregulated activities. No party has demonstrated that the small incremental tracking burden is not warranted to accomodate the significant policy issues.

VII. Conclusion

MCI urges the Commission to adopt its proposals to treat antitrust judgments and settlements as presumptively excluded from the ratebase and encourages the Commission to extend this accounting treatment to judgments and settlements in connection

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[16/] ... [C]onformity [of ratemaking and accounting rules] will enhance the utility of the data reported for regulatory purposes. Further, a single method that is consistent with GAAP can be expected to simplify accounting and reduce carrier recordkeeping and reporting burdens associated with this issue. . . .The Accounting and Ratemaking Treatment for the Allowance for Funds Used During Construction (AFUDC), Notice of Proposed Rulemaking, CC Docket No. 93-50, Released March 22, 1993 at para. 15.

with violations of other federal statutes. Other expenses associated with such lawsuits should be accrued in a deferral account to be disposed of after conclusion of the lawsuit.

Respectfully submitted,

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Dated: October 15, 1993

ATTACHMENT I

NORMAL BUSINESS INCENTIVES

<u>Stockholder risk of aggressive interpretation =</u>

Chance of litigation X Chance of losing X Probable cost of adverse judgment

PLUS

Chance of litigation X Probable litigation costs (including money, reputation, etc.)

<u>Stockholder advantage of aggressive legal interpretation =</u>

Chance of litigation X Chance of winning X Probable cost of compliance

LESS

Chance of litigation X litigation costs (including money, reputation, etc.)

PLUS

Chance of no litigation X Probable cost of compliance

ATTACHMENT II

RATE OF RETURN BUSINESS INCENTIVES

A. Adverse judgments and litigation costs included in ratebase

<u>Stockholder risk of aggressive interpretation =</u>

Chance of litigation X Chance of losing X Probable cost of adverse judgment = Zero (paid by ratepayer)

PLUS

Chance of litigation X Probable litigation costs (no monetary cost as it is paid by ratepayer, only remaining incentives are reputation, etc.)

<u>Stockholder advantage of aggressive legal interpretation =</u>

Chance of litigation X Chance of winning X Probable cost of compliance = Zero (paid by ratepayer)

LESS

Chance of litigation X litigation costs (no monetary cost as it is paid by ratepayer, only remaining incentives are reputation, etc.)

PLUS

Chance of no litigation X Probable cost of compliance = Zero (paid by ratepayer)

B. Adverse judgments excluded from ratebase, all litigation costs included in ratebase

<u>Stockholder risk of aggressive interpretation =</u>

Chance of litigation X Chance of losing X Probable cost of adverse judgment

PLUS

Chance of litigation X Probable litigation costs (no monetary cost as it is paid by ratepayer, only remaining incentives are reputation, etc.)

<u>Stockholder advantage of aggressive legal interpretation =</u>

Chance of litigation X Chance of winning X Probable cost of compliance = Zero (paid by ratepayer)

LESS

Chance of litigation X litigation costs (no monetary cost as it is paid by ratepayer, only remaining incentives are reputation, etc.)

PLUS

Chance of no litigation X Probable cost of compliance = Zero (paid by ratepayer)